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TREASURY FOR STEVE GOOCH

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TAGS: [EFIN](#) [ECON](#) [PGOV](#) [KBIO](#) [PINR](#) [EC](#)

SUBJECT: CORREA DEBT MANAGEMENT: ECUADORIAN OBSERVERS

EXPECT PRAGMATISM

Classified By: A/DCM Alexi Panehal. Reason: 1.4 B and D.

**¶11. (C)** Summary. President-elect Correa and Economic Minister-designate Patino continue to talk about rescheduling Ecuador's external debt. However, former and current Ministry of Economy officials agree that Correa will be pragmatic and conclude that it is not in Ecuador's interest to default. Consensus of opinion is that the risk of default is low, although the likelihood of some debt restructuring is high. See para 15-19 for biographic notes. End summary.

**¶12. (U)** President-elect Rafael Correa and his Economic Minister nominee, Ricardo Patino, have continued to spook the international financial market by talking about restructuring Ecuador's debt, although they have been vague in their media statements as to what they might actually do. On December 14, while in Argentina Correa was quoted as looking for a restructuring Ecuador's commercial, multilateral and bilateral debt with discounts up to 75 percent. On the same day, while in Chile, he was quoted as saying that an external debt restructuring would be "very friendly." Patino, in an interview on December 1, when asked if external debt would be renegotiated replied "definitely," but when pressed as to what would be renegotiated, asked for time to study the situation.

#### Cost-Benefit Calculation Argues Against Default

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**¶13. (SBU)** EconCouns asked a number of former and current Ministry of Economy officials, including one who may serve as an economic advisor to Correa, for their views on how a Correa administration will manage Ecuador's debt, given Correa's and Patino's statements about debt restructuring.

**¶14. (C)** Current Vice Minister for Finance Gene Alcivar, who has been coordinating with Correa's Ministry of Finance transition team, said that he does not expect that Correa would default. Instead, he believes that Correa would see if spending needs can be met with available resources, and if not, enter into discussions with debt holders to see what flexibility there might be.

**¶15. (C)** Pablo Proano was Vice Minister of Finance until October and may serve as an advisor to Correa. Proano said that the cost of servicing Ecuador's external debt in 2007 is marginal, and Correa realizes that the gains of defaulting are negligible. Indeed, Proano argues that Correa should lower his anti-debt rhetoric and issue international debt in 2007 to meet his financing needs. Instead, Proano said, the real debt management challenge is domestic GOE debt, since over \$1 billion in short-term debt has to be rolled over in

¶ 2007. He expects Correa will focus his debt restructuring on two domestic issues: a) persuading the Ecuadorian Social Security Institute (IESS -- by far the largest holder of GOE domestic debt) to replace short term debt with long-term bonds, and b) canceling over \$1 billion in GOE debt to the Central Bank (the bonds were issued to Ecuador Deposit Guarantee Agency (AGD) during the 1999 banking crisis and were assumed by the Central Bank).

¶ 6. (C) Ramiro Galarza, who was Vice Minister of Finance under former President Lucio Gutierrez, also believes that Correa realizes that there is little benefit in defaulting, and will not choose to do so. However, Galarza believes that the Correa administration will be heavily stocked with senior officials who have no government experience, and that inexperience will lead to financial mismanagement which could eventually force the Correa administration to miss payments to international lenders.

¶ 7. (C) Gilberto Pazmino, who also served as Vice Minister for Finance under Gutierrez, also asserted that Correa would not default, although he believes that Correa would attempt to renegotiate debt with foreign bond holders. Pazmino did not speculate how Correa would bring about the negotiations, but he doubts Correa would pursue a simple market-based restructuring of issuing new debt at current low interest rates to retire Ecuador's expensive 2012 bonds, which pay 12 percent.

¶ 8. (C) Fausto Ortiz is the Ministry of Economy transition coordinator for Correa and rumored to be the next Vice Minister for Finance. According to a Latin Source article by former Economy Minister Magdalena Barriero, Ortiz said that liquidity constraints would not force a default in 2007, and

that he favors market-based debt management, including possibly swapping current GOE debt for less expensive debt. A London-based financial analyst reports that Ortiz received assurances from Correa that Correa will not default unless absolutely necessary.

#### Liquidity Crunch

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¶ 9. (C) Although the Ecuadorian public sector will run a surplus of around 4.5% of GDP this year, the Ministry of Economy faces a cash shortfall, since windfall petroleum income is locked up in petroleum reserve funds and President Palacio has increased spending at the end of his term. Current Vice Minister Alcivar confirmed that the GOE is hard pressed to pay the extra monthly salary that is paid in December (13th month salary). Separately, Ramiro Galarza, who is unofficially assisting the current Finance team, reported that the GOE could barely scrape up the cash to make a December payment to external bondholders, and will be late in making a payment to an unnamed multilateral development bank (invoking a contractual provision that allows it to delay payment up to 30 days).

¶ 10. (C) Pablo Proano was not concerned that the current liquidity squeeze would force Correa's hand on debt management. He said that in its first few months the Correa administration will not be prepared to implement any spending projects, and therefore will only need to make basic salary and debt expenditures. He said that Correa's ministerial nominees have no government experience and therefore will be very slow and ineffective in implementing government programs. He added that this would relieve pressure on the Ministry of Economy to provide financing, although it would make it difficult for Correa to implement his agenda.

¶ 11. (C) Galarza echoed Proano's comment that an inexperienced Correa team will be very slow in implementing Correa's social spending agenda, and implied that would affect Correa's ability to maintain popular support. Unlike Proano, he thought that the Correa economic team would not be able to effectively manage a complex cash management situation made worse by significant arrears, which could lead

to an accidental default.

#### Alternate Sources of Financing

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**¶12. (C) Multilaterals:** EconCouns asked several interlocutors about additional sources of financing (such as multilateral lenders) the Correa administration could draw upon to cover budget gaps. Fausto Ortiz simply said that he would identify spending and financing options for the Correa administration, and whether it looked to support from institutions like the World Bank or IDB would be political decision. Proano said that he hopes Correa would look to the multilateral lenders for support, although he noted Correa's sour experience with the World Bank, which refused to make a project disbursement during Correa's brief tenure as Minister of Finance in mid-2005. Proano said that the World Bank and IDB would have to be flexible in their approach to Correa, and be willing to help address his agenda instead of attempting to impose their priorities on Correa.

**¶13. (C) IEES:** As noted in para 5, Proano thought much of the Correa administration's financing needs could be met by loans from the IEES and international lenders. Conversely, Galarza thought that an inexperienced Correa finance team would not work effectively with IEES, particularly if the GOE was in danger of defaulting on its external debt.

**¶14. (C) Petroleum Reserves:** Proano said that in a crunch, the emergency provisions of the petroleum funds would allow the government to draw on those funds to make debt payments. On the other hand, Galarza opined that it would be difficult for Correa to draw on the petroleum reserve funds since working level Ministry of Economy officials would be reluctant to sign necessary paperwork for fear of being prosecuted.

#### Personalities and Bio Notes

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**¶15. (C) Correa:** Both Galarza and Pazmino were certain that the Ministry of Economy would have little room to establish economic policy, and would instead respond to Correa's

instructions. Pazmino opined that Correa would not respond well if his subordinates challenged his views, asserting that if someone disagrees with Correa's perspective, Correa would quickly turn a policy disagreement into a personal challenge.

Former Economy Minister Magdalena Barreiro, who also served as Vice Minister under Correa at the Ministry of Economy, said that at times Correa welcomed input, but at other times she and fellow Vice Minister Patino would commiserate when Correa refused to follow their advice. Barreiro also said that Correa is far more inclined to listen to guidance from those who are to the left of his position than those who are to the right.

**¶16. (C) Patino:** Proano volunteered that he is concerned that Patino will be a weak Minister of Economy. He said that Patino initially served as Correa's chief of staff when Correa was at the Ministry of Economy, and subsequently became Vice Minister of Economy, where he only served for a month. As chief of staff, he did a good job of setting an agenda and helping to develop consensus. However, Proano stressed, Patino spent relatively little time at the Ministry, and during that time had essentially no exposure to financial issues. In addition, Proano doubts that Patino has the administrative capacity to effectively manage the Ministry of Economy. Proano noted that the Minister of Finance sits on over a 100 different boards, and an ineffective Minister quickly lets his participation on those boards define his agenda, rather than advancing his own agenda. Proano believes that Patino will fall into that pattern.

**¶17. (C) Pazmino:** Pazmino reported that when he was attempting to negotiate Ecuador's bilateral debt in the Paris Club, he was harshly criticized by Patino in letters and the media. At

that time Patino was working for an NGO that questioned the legality of Ecuador's debt.

¶18. (C) Fausto Ortiz. Ortiz is rumored to be Correa's nominee for Vice Minister of Finance. One financial analyst reports that Ortiz privately confirmed that he will accept the position. However, he has not been publicly named by either Correa or Patino. Ortiz previously served in the Ministry of Economy for about a year, about half the time as Under Secretary for Budget, and the rest as Vice Minister for Finance. Galarza opined that he would be a solid Vice Minister, but believed that Ortiz alone would not be sufficient to bring good management and policies to the Ministry.

¶19. (C) Proano. Proano studied with Correa at the University of Illinois and worked at the Ministry of Economy under Correa and Patino. He describes himself as a friend of Correa, although he asserts that he does not share Correa's ideological views. He was Vice Minister of Finance until October, and after resigning, returned to teach at the Catholic University in Quito. He told EconCouns that he was offered a position in the Correa administration, but declined, offering instead to serve as an informal advisor. Galarza described Proano as a solid official, but doubted that he has the presence to advance his own views in a Correa administration.

Comment

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¶20. (C) It is striking that a sizeable number of experienced former finance officials are unanimous that Correa understands the cost of a default is high and will not willingly default. However, neither they nor we know how Correa will manage his debt policy once he assumes the Presidency. We suspect Correa will adapt his views on debt management to the economic and political pressures that he will face in office. He may very well be pragmatic, as our contacts have suggested. However, he and his Minister of Economy also have a strong anti-debt bias, and in a difficult situation those instincts may prevail.

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